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Report on Personal and Corporation Income Tax Bill (House Bill 1846; Chapter 627, Oregon Laws, 1963) State Ballot Measure No. 1

City Club of Portland (Portland, Or.)

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REPORT

on

**PERSONAL AND CORPORATION
INCOME TAX BILL**

(House Bill 1846;
Chapter 627, Oregon Laws, 1963)

State Ballot Measure No. 1

Purpose: To increase state revenues. Abolishes federal tax deduction. Lowers personal tax rates. Provides minimum tax. Increases corporation rates. Effective on or after January 1, 1963.

To the Board of Governors,
The City Club of Portland:

Your Committee, authorized to study the above ballot measure to be submitted to the voters at a special election October 15, 1963, reports and recommends as follows:

I. INTRODUCTION

House Bill 1846 ⁽¹⁾ was enacted as an amendment to the present income tax act, to produce an estimated \$64 million in additional revenue to the state. Of this amount, \$50 million would come from the elimination of the federal tax deduction and from other revisions of the existing income tax law. The remaining \$14 million, if needed, would be collected by the accelerated payment of income taxes withheld by employers.

The effective date of the law was suspended by the filing of a referendum petition, which necessitates the referral to the voters, at a special election, of the tax measure for approval or rejection.

The sponsor of the petition was Mr. J. Francyl Howard, president of "Citizens Committee for Economy and Equitable Taxation", and editor of **Greater Oregon**, a weekly newspaper published in Albany, Oregon.

(1) House Bill 1846 properly should be called "Ballot Measure No. 1", inasmuch as it is no longer a bill, but as it is popularly referred to by its bill number, it will be called "HB 1846" in this report.

Over 55,000 valid signatures were filed in support of the petition, although only 23,185 signatures were necessary to secure a referendum. A suit was filed contesting the accuracy of the proposed ballot title certified by the Attorney General, but the Oregon Supreme Court upheld the wording of the ballot title.

A "yes" vote on the ballot will approve measure HB 1846. A "no" vote will reject it.

II. SCOPE OF COMMITTEE RESEARCH

Although only 45 days remained between the filing of the referendum petition and the date set for the special election, a great deal of information was disseminated and numerous viewpoints have been expressed on both sides of the issue. The greatest problem faced by your Committee in the short time allowed for this study was to examine the data and then discount that which the Committee felt to be without factual foundation.

In addition to reviewing much of the material published by groups and individuals, both in support of and opposed to HB 1846, your Committee interviewed the following persons:

Dr. Roy Lieuallen, Chancellor, Richard Collins, Budget Officer, and Allan Hart, Board member, Oregon State System of Higher Education;

Dr. Melvin Barnes, Superintendent, John H. Nellor, Administrative Assistant, School District No. 1 (Portland Public Schools);

Richard K. Brown, chairman, Robert M. Hall, contact director and former chairman, and Waldo Taylor, member, Portland Chamber of Commerce Taxation Committee;

Walter J. Pearson, State Senator from Multnomah County and chairman of the Senate Taxation Committee;

Richard Eymann, State Representative from Lane County and chairman of the House Taxation Committee;

John D. Mosser, State Representative from Washington County and member of the Legislature's Joint Ways and Means Committee;

Walter W. R. May, editor and publisher, **Oregon Voter**;

Wiley Smith, former Multnomah County Assessor and Portland coordinator of the petition movement;

Dr. Henry Osibov, Research Director, Oregon Education Association, and

Governor Mark Hatfield, by letter.

III. BACKGROUND INFORMATION

The 1963-65 budget was the subject of extensive disagreement and, as finally passed, provided for a 10.3 per cent increase over the last biennium, primarily in the field of education but also for other state services.

Based on the budget as finally passed, the State Tax Commission estimated that \$59 million would be needed in addition to the anticipated collections under the existing tax law. HB 1846 is intended to supply this additional revenue and was passed only after extensive discussion and bitter disagreements, in the longest session in the history of the Oregon Legislature. Many methods of taxation were proposed, including other means of revising the income tax structure, as well as the utilization of alternatives to the income tax.

The following schedule, prepared by the State of Oregon Legislative Fiscal Committee, shows sources of General Fund revenue and the General Fund appropriations for 1963-65 as compared with 1961-63:

Sources in Millions:	1961-63	1963-65
Personal and corporation income		
taxes under present law	\$233.8	\$250.3
Additional under HB 1846		64.2
Other sources	93.5	92.7
Total	\$327.3	\$407.2
Appropriations in millions:		
Operating Budget:		
Higher Education	61.5	79.6
Dept. of Education:		
Administration	3.4	3.5
Community Colleges	2.4	4.3
Other Special Programs	5.9	6.5
Basic School Apportionment	120.6	135.1
Mental Institutions	29.0	33.3
Correctional Institutions	11.1	13.1
Public Welfare	41.5	41.9
General Salary Adjustments:		
Higher Education	7.2	2.5
Department of Education	.2	.1
All Other	7.2	3.4
All Other	60.6	65.5
Subtotal	\$350.6	\$388.8
Capital Construction Budget:		
Higher Education	9.8	11.5
All Other	6.3	4.0
Subtotal	\$ 16.1	\$ 15.5
TOTAL	\$366.7	\$404.3

As indicated by the foregoing, the revenues during the 1961-63 biennium were insufficient to cover appropriations during that period. The additional funds necessary to meet the appropriations were available as a result of a surplus carried over from the 1959-61 biennium.

Anticipating that HB 1846 might be referred, the Legislature allocated \$300,000 for a special election.

Governor Hatfield had advocated revisions in the tax program different from those embodied in HB 1846 and announced his displeasure with the measure as ultimately passed. The Governor did not exercise his veto power, however, and allowed the bill to become law without his signature.

Despite his original opposition to HB 1846, the Governor has announced his support of the measure and recommends its approval. Some legislators also have reversed their initial positions.

IV. BRIEF ANALYSIS OF HOUSE BILL 1846⁽²⁾

Summary of Major Changes Embodied in New Law:

Personal income tax:

1. Eliminates federal income tax deduction except to allow deduction of federal income taxes paid for years prior to 1963 and to tax as income refunds received of federal income taxes previously allowed as a deduction.
2. Tax Rates:
 - (a) New income tax rates adopted are set forth in Table I:

TABLE I.
NEW INCOME TAX RATES

Individual or Separate return			Joint return and head of household		
Taxable Income	Tax on Col. 1	% of Excess	Taxable Income	Tax on Col. 1	% on Excess
\$ 0	\$	2%	\$ 0	\$	2%
250	5.00	3%	500	10.00	3
500	12.50	3.5	1,000	25.00	3.5
750	21.25	4	1,500	42.50	4
1,000	31.25	4.25	2,000	62.50	4.25
1,250	41.88	4.5	2,500	83.75	4.5
1,500	53.13	4.75	3,000	106.25	4.75
1,750	65.00	5	3,500	130.00	5
2,000	77.50	5.25	4,000	155.00	5.25
2,250	90.63	5.5	4,500	181.25	5.5
2,500	104.38	5.75	5,000	208.75	5.75
2,750	118.75	6	5,500	237.50	6
3,000	133.75	6.25	6,000	267.50	6.25
3,250	149.38	6.5	6,500	298.75	6.5
4,000	198.13	6.75	8,000	396.25	6.75
6,000	333.13	7	12,000	666.25	7
8,000	473.13	7.5	16,000	946.25	7.5

- (b) Head of household—privileged to use tax rates for joint return.
 - (c) Minimum tax—apparently intended to be the higher of \$5 per return, or 1% of adjusted gross income. However, the wording of Section 4 (3) of the Act, read together with related Section 15 which sets forth the credits allowed against the net income tax, is ambiguous, so that the intended minimum may be higher than generally understood.
 - (d) Capital gains—maximum tax of 5 per cent on gain from sale of capital assets held for one year or more.
3. Capital gains and losses:
 - (a) Definition of capital asset changed to include rental property if held for 2 years prior to sale.
 - (b) Eliminates need for reinvestment, in Oregon and other related provisions in present law.
 - (c) Capital losses—limited to amount of capital gains plus lesser of net income or \$1,000. Five-year loss carryover.
 4. Deductions:
 - (a) Medical expenses—maximum limitation removed.
 - (b) Administrative expenses of estates—deduction allowed if not claimed for inheritance tax purposes.
 - (c) Minor technical changes in other deduction sections.

⁽²⁾ The Committee did not feel it was feasible to include the full 20-page text of HB 1846 in its report.

5. Credits against tax: (allowable only to natural persons):
 - (a) Allows credits against tax instead of person and dependency exemptions.

Taxpayer and spouse.....	\$22 each
Dependents	\$22 each

 No apportionment for partial years.
 - (b) Students may qualify as dependents even if they earn over \$600 in the taxable year.
 - (c) Additional credits against tax:

Blind	\$22
Over 65	\$11
6. Every individual having net income of \$500 or more, or gross income over \$4,000 must file a return.
7. The exemption of \$600 presently allowed estates and trusts is eliminated. Many fiduciaries not now required to file a return will have to file and pay the minimum tax.

Corporation Excise Tax:

1. Rates changed to:
 - (a) Manufacturing, processing or assembling businesses who pay personal property tax in Oregon on their inventories:
 - 4% on 1st \$25,000 of net income
 - 4½% on excess
 - Property tax offset provisions eliminated
 - (b) Other business corporations—(except banks and financial institutions):
 - 5% of 1st \$25,000 of net income
 - 6½% on excess

Payment of Withholding Taxes:

Effective with taxes withheld in April 1965, employers will be required to pay monthly to the State Tax Commission income taxes withheld from employees (if \$100 or more), unless the Department of Finance and Administration and the Tax Commission determine on March 1, 1965 that the estimated General Fund revenues will be within \$1,000,000 of equalling the appropriation for the biennium. If the revenues are sufficient, the present quarterly payment basis will continue in effect.

Local Property Tax Relief Account:

Effective in 1964 and subsequent years, if estimated General Fund revenues for the biennium produce a surplus in excess of \$10,000,000, such excess will be put in local property tax relief account to be allocated to counties, cities and school districts.

Changes in personal income tax payments for selected taxpayers are shown in Table II prepared by the Research and Planning Section of the State Tax Commission. ⁽³⁾

⁽³⁾ Assumptions made:

- a. Joint return of husband and wife with two dependents.
- b. Federal and state taxes computed under present law on basis of four personal exemptions and dependency credits, a deduction of 10 per cent of personal income or \$1,000, whichever is less, and accrued state or federal income taxes.
- c. The tax under HB 1846 has been computed on the above assumptions, with the exception that no allowance has been made for federal tax paid as a deduction for state income tax purposes.

TABLE II
CHANGES IN PAYMENTS IF ITEMIZED DEDUCTIONS USED

Tax Payments Under Present Law				Tax Payments Under HB 1846			Change in Payments		
TOTAL INCOME	STATE	FEDERAL	TOTAL	STATE	FEDERAL	TOTAL	STATE	FEDERAL	TOTAL COST TO TAXPAYER
\$ 1,000	\$ —	\$ —	\$ —	\$ 10	\$ —	\$ 10	\$ 10	\$ —	\$ 10
2,000	—	—	—	20	—	20	20	—	20
3,000	7	59	66	30	54	84	23	(5)	18
4,000	29	234	263	51	230	281	22	(4)	18
5,000	58	408	466	97	401	498	39	(7)	32
6,000	91	582	673	148	570	718	57	(12)	45
7,000	129	754	883	202	740	942	73	(14)	59
8,000	172	938	1,110	260	919	1,179	88	(19)	69
9,000	220	1,126	1,346	319	1,104	1,423	99	(22)	77
10,000	270	1,313	1,583	380	1,288	1,668	110	(25)	85
12,500	407	1,860	2,267	549	1,823	2,372	142	(37)	105
15,000	562	2,470	3,032	722	2,428	3,150	160	(42)	118
25,000	1,196	5,434	6,629	1,462	5,332	6,794	266	(102)	164
50,000	2,489	16,826	19,314	3,337	16,347	19,684	848	(479)	369
100,000	4,266	48,121	52,386	7,087	46,089	53,176	2,821	(2032)	789

The validity of the figures in the final column of Table II are dependent upon the assumption that all taxpayers itemize their personal deductions. Such itemization reduces, by the amount of the state tax, the taxable income reported on the federal return. Where deductions are itemized the combined increase in federal and state taxes is less, as shown by Table II, than the state tax increase.

However, it is inaccurate to state that the combined increase for every Oregon taxpayer will be less than the state tax increase. According to the latest available figures⁽⁴⁾, 59 per cent of all federal personal income tax returns filed did **not** itemize deductions. Accordingly, this 59 per cent did not receive any federal deduction for state income taxes paid. Approximately the same percentage of Oregon taxpayers took the standard deduction on their 1961 state returns.

Table III demonstrates the increases in personal income tax payments that will be paid by Oregon taxpayers who do not itemize deductions, in the event HB 1846 becomes law. It will be observed that the additional total tax is higher for each bracket than in Table II.

TABLE III
CHANGES IN PAYMENTS IF STANDARD DEDUCTION USED

Tax Payments Under Present Law				Tax payments Under HB 1846			Change in Payments		
TOTAL INCOME	STATE	FEDERAL	TOTAL	STATE	FEDERAL	TOTAL	STATE	FEDERAL	TOTAL COST TO TAXPAYER
\$ 1,000	\$ —	\$ —	\$ —	\$ 10	\$ —	\$ 10	\$ 10	\$ —	\$ 10
2,000	—	—	—	20	—	20	20	—	20
3,000	11	65	76	30	65	95	19	—	19
4,000	37	245	282	61	245	306	24	—	24
5,000	68	420	488	111	420	531	43	—	43
6,000	105	600	705	166	600	766	61	—	61
7,000	151	780	931	225	780	1,005	74	—	74
8,000	199	976	1,175	286	976	1,262	87	—	87
9,000	252	1,174	1,426	349	1,174	1,523	97	—	97
10,000	306	1,372	1,678	414	1,372	1,786	108	—	108
12,500	434	1,966	2,400	582	1,966	2,548	148	—	148
15,000	594	2,616	3,210	757	2,616	3,373	163	—	163

(Higher income brackets are the same as Table II, as virtually all in these brackets will detail deductions.)

(4) Research Institute of America, **Research Institute Recommendations**, Sept. 6, 1963, page 4.

Inasmuch as the State Tax Commission used (See Table II) a minimum tax of 1 per cent of adjusted gross income, even though the law is ambiguous in this regard, your Committee has also used the same minimum tax in Table III concerning standard deduction taxpayers.

Irrespective of how the income tax is distributed, it is estimated that the new tax law would raise approximately \$50 million (not including a possible \$14,000,000 from withholding tax speedup) in addition to the \$250 million to be collected in the current biennium under the present personal and corporation income tax law. Changes in corporation tax law would raise less than \$1 million of this increase. Thus, the brunt of the increase would be born by the individual taxpayers at an average increase of 25 per cent. Only a small part of this increase would be offset by the reduction in the federal tax paid.

The following have been mentioned as improvements HB 1846 makes in the tax law:

1. It broadens the base with its minimum tax requirements by requiring more people to pay.

2. With the elimination of the federal tax deduction, it adds greater progressivity to the tax rates without the psychological disadvantage of high rates showing in the tax tables.

3. It improves the tax climate for manufacturing corporations by setting lower published tax rates of 4% and 4½%.

4. It gives special treatment to capital gains without some of the qualifying circumstances required by present law.

5. It gives to certain taxpayers tax-saving benefits not available under present law.

6. It may provide some property tax relief.

7. It eliminates the necessity of resorting to a sales tax which, whether or not it is preferable, runs the risk of rejection by a referendum.

The principal criticisms leveled at the changes in the tax law by HB 1846 are:

1. Steeply progressive income tax rates are not only inequitable but are damaging to the economy in their destructive effect on investment capital and individual initiative.

2. The elimination of the federal income tax deduction effectively increases the progressivity of the rates and does so in a deceptive manner as it taxes income never received or never available to the taxpayer.

3. The minimum tax provisions expend the burden of paying taxes to many more small taxpayers.

4. There is no justification for the provisions—which eliminate the personal exemptions, and dependency credits—which are directed primarily against higher income individual taxpayers and estates and trusts.

5. The capital gains provisions, which are touted as an “improvement” would have negligible benefits for most taxpayers. The capital loss limitation, with only five-year carryover, in some cases will disallow offsetting the full amount of the capital loss against income.

6. Progressive rates for corporations, initiated by HB 1846, would be damaging to the state’s economic climate.

7. HB 1846 contains errors and ambiguities which will lead to difficulties in interpretation. If the measure becomes law, future legislation will be needed to correct its present technical deficiencies.

V. ARGUMENTS IN FAVOR OF THE MEASURE

The following are the arguments considered by your Committee:

1. Quality and availability of education, particularly higher education, will be reduced if funds provided by the measure are lost.
2. Budgets of school districts in most districts will be affected severely by failure of the measure.
3. Passage will further the long-term objective of shifting 50 per cent of the burden of local school costs to the state General Fund.
4. Passage will prevent property taxes from rising as high and as fast as would be anticipated without the revenue raised by this bill.
5. The provisions of the new tax law are an improvement over those in the present law, especially the lower published rates and the provisions for capital gains, heads of household, student credits, and broadening the tax base.
6. If this tax bill fails, the Legislature will not pass a more desirable measure.
7. No new tax program can win the popular support required by an inevitable referendum.
8. Voters do demand services from the state and should expect to pay for them. The number of people demanding service is increasing faster than the taxpaying population.

VI. ARGUMENTS AGAINST THE MEASURE

The following are the arguments considered by your Committee:

1. Income and property taxes are too high, and they are likely to increase; reasonable budget demands will increase. The voters should demand new legislation to develop a balanced program using another major source of revenue, such as the sales tax, and possibly other taxes. Only New York, along with Oregon, receives over 50 per cent of its revenue from income tax.
2. The changes in the tax law are undesirable, in particular the loss of the federal tax deduction, changes in exemptions and dependency credits, and the minimum tax of \$5.00 or 1 per cent of adjusted gross.
3. The trend toward constantly raising income taxes should be curbed.
4. The state budget is higher than necessary, and revenue is underestimated. The budget could be balanced under the present revenue law.
5. The state is attempting to give more services than the present forms of taxation should bear.
6. The Governor and the Legislature, if called to special session, will have an opportunity to determine, more accurately than present estimates, the income under existing law; before allocation of funds for the second year of the biennium, the Governor and the Legislature will have time to determine the budgetary cuts that should be made and the revenue-producing measures necessary and most desirable.
7. Education costs are too high because of:
 - (a) Small ratio of students to teachers, especially in higher education;
 - (b) Inadequate use of facilities, especially in higher education;
 - (c) Use of "name" professors, drawing high salaries;
 - (d) Tenure system in elementary and secondary schools resulting in excessively high salaries for many teachers;
 - (e) Educators a strong pressure group in Oregon who have driven education costs beyond Oregon's ability to pay.
8. At least Portland School District No. 1 can make up most of the loss of additional state funds from present levies already authorized by voters.

VII. GENERAL EFFECTS OF PASSAGE OR DEFEAT OF HB 1846

The effect of a "yes" vote on HB 1846 will be to approve the increase in revenue and the manner of collecting that revenue. Approval of the increase in revenue will eliminate any problem of meeting current appropriations. It will imply confidence in the need and justification for the appropriations. Passage of the measure will effect changes in the tax law and indicate approval or tolerance of the tax law changes by the majority of voters.

The effect of a "no" vote on the bill will be to disapprove either the increase in revenue or the means for increasing revenue, or both the increase and the means. No other implication necessarily follows passage or defeat of the bill, lobbyists' extravagant claims to the contrary notwithstanding. (There are almost as many different opinions as to what will occur in case of a "no" vote as there are views expressed.)

The propriety of the legislative appropriations is not referred to the people in this bill. The voter can only vote "yes" to pay for the appropriations, or "no" and leave the solution of the problem of cutting the appropriations or raising the revenue in another manner, to the Governor or the Legislature.

If HB 1846 is defeated: Because appropriations already have been made for the 1963-65 biennium, the alternatives open to the Governor are to call a special session of the Legislature, make such changes in the budget as are within his statutory authority, or resort to issuance of warrants.

The Governor has advised your Committee: "I have made no firm decision that a special session will or will not be called." In the absence of a special session, the first appropriate move would be to reappraise the estimates of general fund revenue under present law. Your Committee is persuaded by testimony of informed witnesses interviewed, and by the past history of conservative revenue estimates of the State Tax Commission, that the current income projections are too low.

The second step would be to reduce expenditures. In the light of the opinion of the Attorney General, handed down September 10, 1963, regarding the Governor's lack of allotment control over basic school support, it appears that the Governor could effect economies only as to 60.7 per cent of the budget, or \$245 million. This portion of the budget makes up the unshaded area in Chart I. Concentration of budget cuts in this area could mean reductions of up to 24 per cent, using original revenue estimates. The Governor's authority to reduce budgets extends to all state agencies. Your Committee has been advised that Oregon has the largest number of state, county and municipal employees per capita of any state in the nation. Some persons interviewed believed that this number could be reduced without seriously endangering the level of services.

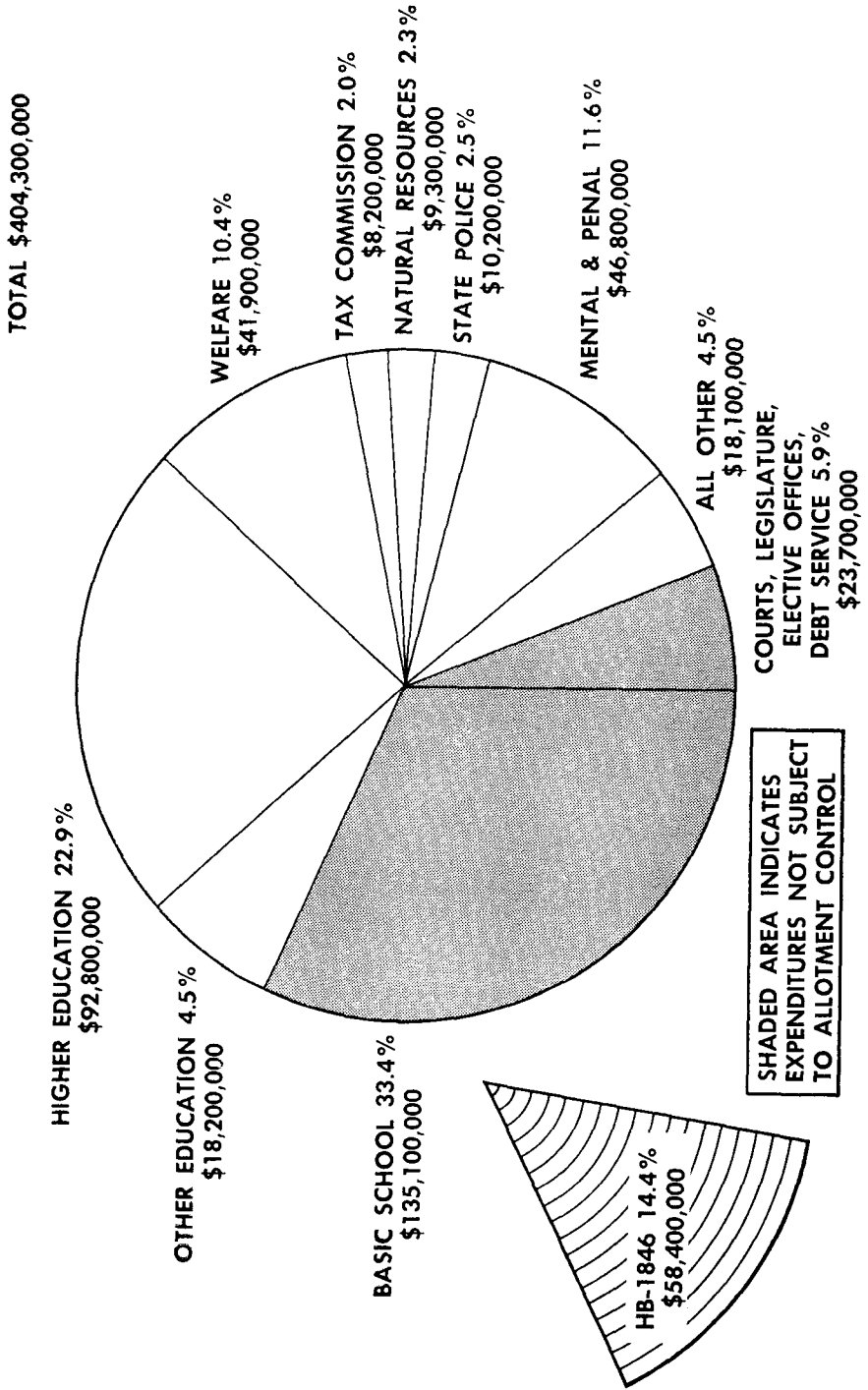
The effect of budget cuts on education are discussed elsewhere in this report.

If the Governor is convinced that he cannot balance the budget without a reduction in basic school support, it is assumed that he will call a special session of the Legislature. In the event a special session is called, the Legislature could (1) reduce allocations, (2) pass new tax measures, or (3) accomplish a combination of both.

Your Committee believes that a "no" vote can have an effect of indicating to the legislature that the voters do not wish continued increases in the present tax program, but would prefer a new tax source, such as a sales tax and/or a cigarette tax. All the persons interviewed

CHART 1

GENERAL FUND EXPENDITURES 1963 - 1965



anticipated that the high level of services provided by the state will necessitate higher budgets in the future. Present sources of revenue would not have balanced the 1961-63 budget were it not for a surplus of funds carried over from the 1959-61 biennium. A "no" vote may indicate a desire of the voters to support such services from tax sources in addition to the income tax.

Your Committee is advised that the revenue raised by HB 1846 is to be used to provide for the expansion of existing services. The Committee challenges statements to the effect that without the revenue provided by HB 1846, existing services will be vitally impaired. A "no" vote will necessitate some budget cuts. It is not yet clear where those cuts will be made or to what degree they must be made. In any event, it does not appear that they will exceed \$50 million, or approximately 12 per cent of the general fund budget. Some estimates indicate that a cut of only 5 per cent will be necessary to balance the budget without the HB 1846 revenue.

Your Committee is critical of the statements that have been made by both sides concerning the effects of defeat of HB 1846. The proponents of the measure have threatened reduction of vital services in cases where their budgets could be reduced by striking items that are less than vital. Conversely, some opponents of the measure irresponsibly have stated that no effect will be felt by defeat. Your Committee is of the opinion that some reduction will be necessary, but because of the conservative revenue estimates of the State Tax Commission, not the full \$60 million. Your Committee is also of the opinion that this reduction can be made without significantly impairing the standards of service provided by the state during the last biennium.

VIII. EFFECT OF DEFEAT ON EDUCATION

No determination of the effects on Oregon's public education by defeat of HB 1846 can be made without first making a number of assumptions. There are few assumptions that we can make with reasonable certainty. However, your Committee has concluded that the following course of events most likely would transpire in the event the tax bill is defeated:

1. As set forth in the opinion of the Attorney General, basic school support cannot be reduced without legislative action. Accordingly many persons have assumed that inasmuch as basic school support constitutes \$135 million of a \$404 million general fund budget, there will not be sufficient flexibility in other budget items to absorb the loss of revenue to have been raised by HB 1846. The indefiniteness of the amount of revenue that will be collected under the existing revenue measure, and the apparent reluctance of the Governor to call a special session of the Legislature, would indicate that there is a possibility that sufficient reductions might be made in other areas without reducing basic school support.

2. A special session of the Legislature is possible either immediately or after revenue receipts for the current biennium are known with greater certainty.

3. Your Committee is unable to project the results of a special session of the Legislature but in the event such a session occurs, there will be a reduction in allocation, new tax measures, or a combination of both.

4. It could be assumed that if basic school support is reduced, it will be cut to a level approximating that of the 1961-63 biennium.

The 1963 Legislature increased basic school support 12 per cent, from \$120.6 million in 1961-63 to \$135.1 million in 1963-65. However, the basic school support payments to each district only provide about 33 per cent of the district's total operating expense.⁽⁵⁾ Accordingly, a removal of the present biennium increase of 12 per cent would constitute only a 4% average reduction in the budget of the individual school district. The Legislature required some individual districts to reduce their property tax levies to some extent in return for the increased basic school support. The revenues these districts failed to levy is thus lost to them. It seems likely, therefore, that a cut in basic school support, if made, would be moderate because of school district reliance on promised state aid, at least for the first year of the biennium.

A. Probable Effect on School District No. 1 (Portland)

The first year of the 1963-65 biennium is already under way. School District No. 1, in reliance upon promised increased basic school support, limited its authorized \$2,500,000 additional operating levy for the current year to \$500,000. This action, taken in July, was based on the legislative allocation of support to the district in the amount of \$9,106,000. Any reduction in the school support received in the year ending July 1, 1964 will result in the permanent loss to School District No. 1 of that reduction. Assuming a cut in basic school support to last year's level, the District would lose approximately \$1 million of total budget of \$40 million. Absorbing such a reduction this year would obviously present some serious problems, particularly in view of commitments which have been made for the current school year; yet these problems would not appear insuperable.

During the second year of the biennium, School District No. 1 is in a uniquely favorable situation, inasmuch as the voters have authorized it to make a special levy of \$2,500,000 in property taxes. In other words, without special vote, School District No. 1 can and would impose an additional property tax substantially compensating for loss of state revenue. This loss of state revenue would consist of roughly \$1 million in basic school support, and nearly an additional \$1 million available only in 1963-64 by way of distribution by the State Land Board of accumulated revenue in the Common School Fund. On the other hand, it may mean an additional burden on the local property taxpayers of slightly over two mills, or about 3 per cent, a burden which could and perhaps would be imposed by the District in any event.

If basic school support is cut, the effect on School District No. 1 would not be devastating, although it would impair the budgeted school program for this year and would limit the increase in budget next year to the amount provided by the normal 6 per cent increase in tax base.

B. Effect on Outlying School Districts

The effect on other school districts, both in the Portland area and in other parts of the state, would vary according to their dependence on basic school support. There have been submitted to your Committee figures showing projected property tax increases in Lane County varying from 2 mills to 18 mills, as compared with a potential estimated Portland increase in 1964-65 of about 2 mills. The most marked difference between the

(5) Legislative Fiscal Committee Staff Report No. 63-3 September 10, 1963.

situation in Portland and in the other school districts is that, except in a handful of areas, no increase in property tax is available without special elections and voter approval. Special levies may not be reliable as a source of revenue because of their dependency on voter acceptance. Therefore, if basic school support is cut the effect on elementary and secondary education generally will be much more seriously felt outside of Portland School District No. 1.

C. Effect on Higher Education

Inasmuch as the Oregon State Board of Higher Education is a state agency over which the Governor **does** have budgetary control, the effect of defeat of the measure would clearly be different on higher education from that on elementary and secondary education. The Executive Department already has frozen capital construction on buildings for which commitments have not been made, although about \$4 million of construction which was commenced before the referendum petition was filed will be continued.

The total operating budget of the System of Higher Education for instruction totals \$83.5 million, of which approximately \$61.7 million is received from the general fund. In event this budget is reduced by the full amount of the increase over the last biennium, such reduction would amount to approximately \$10 million. Of the increase in the current operating budget, approximately \$3 million is for salary increase and improved services, leaving a \$7 million increase to provide the same services as last biennium for an increased number of students.

In order to effect savings during the last biennium, the Board adopted measures which impaired the standards of service it wished to maintain. The reduction of its budget would necessitate the continuance of some of these measures.

Your Committee has been advised that the Board has adopted the policy that the quality of education will not be diminished, but that fewer persons would be served if HB 1846 is rejected. The execution of this policy could result in higher scholastic entrance requirements and higher tuition.

D. General Effect

While education is of paramount importance, the issue nonetheless has been raised as to the extent of Oregon's ability to spend on education. In 1961, Oregon ranked 20th nationally in per capita income and below the national average.⁽⁶⁾ Oregon ranked 9th on expenditures per student in grade and high school⁽⁷⁾, and 9th per capita in expenditures for public college education.⁽⁸⁾ One source has claimed that Oregon has the third highest cost per elementary student in the nation. Whether these figures are cause for pride or fiscal concern remains a difficult issue to resolve.

(6) NEA Research Report, 1963, Pg. 42.

(7) Ibid. Pg. 58

(8) Ibid, Pg. 59

IX. MAJORITY DISCUSSION

Many alternatives must be weighed in determining the advisability of approving or rejecting HB 1846. On the one hand, rejection will mean some reduction in the expenditures for education and other public services which the Legislature approved. On the other hand, acceptance will mean the continuance of an onerous means of taxation which your Committee feels now should be supplemented with other kinds of revenue producing measures.

Future legislatures rightfully will approve budgets in excess of the one approved for this biennium. The citizens of Oregon have demanded and received a high level of state services. However, your Committee believes that these expanded services no longer can be supported chiefly by income and property taxes. The increased burden of personal income tax imposed by HB 1846 is 25 per cent.

Operating budget requests this biennium were approximately 16 per cent higher than the budget approved by the Legislature. Budget requests for the next biennium reflecting increased population and desire for increased services probably will require further revenue increases. A rejection of HB 1846 will compel the Legislature to look to other forms of revenue-raising.

X. MAJORITY CONCLUSIONS

Therefore, the majority of your Committee concludes that:

1. HB 1846 continues and increases the burden of the state income tax; this burden should be eased by adopting new forms of taxation.
2. The long-term benefits to be derived from a defeat of this measure outweigh possible disadvantages of reductions during this biennium of expenditures for public education and state services.

XI. MAJORITY RECOMMENDATION

The majority of your Committee therefore recommends that the City Club of Portland oppose the passage of State Ballot Measure No. 1 by urging a "no" vote thereon.

Respectfully submitted,

Clifford N. Carlsen, Jr.

Sidney M. Cooper

Roger S. Meier

Arden E. Shenker, and

Timothy F. Maginnis, *Chairman*
for the majority

XII. MINORITY DISCUSSION

Your Committee has heard no substantial criticism of the level of General Fund spending or of its 10.3 per cent increase from \$366.3 million in 1961-63 to \$404.3 million in 1963-65. The Majority fails to emphasize sufficiently that even in 1961-63 there was a \$30 million deficit. We have heard valid criticism both as to the technical provisions and general undesirability of the 25 per cent personal income tax increase provided by HB 1846. The Minority does not, however, share the optimism of the Majority as to what defeat of the measure would mean, within the present biennium and particularly in the following years:

1. The State Tax Commission, with the concurrence of the executive and legislative branches, concludes that continuing the current level of state services would leave a \$59 million adjustment to be made.

2. Makeshift adjustments during the current biennium, made by the Governor or the Legislature or both, could temper the immediate impact of the revenue loss, but serious permanent harm would be done to higher education; all state services would suffer.

3. Nothing would or could be done to meet the present need to sustain capital expenditures; Oregon's investment in physical facilities would stagnate.

4. There being no assurance of additional revenue from other sources, Oregon's expenditure on service will remain stationary while cost of living and population (particularly youthful and elderly population) continue to increase.

5. No other tax program is foreseeable to win the popular support required by the inevitable referendum.

6. No other form of tax can produce revenue for the full biennium.

XIII. MINORITY CONCLUSION

Oregon is faced with the dilemma of approving the only major tax measure passed by the Legislature or retrenching state services for an indefinite period. If the tax should prove to be unduly onerous, it can be amended; but the state cannot risk the unknown dangers of not meeting its commitments.

XIV. MINORITY RECOMMENDATION

The minority of your Committee recommends that the City Club of Portland support State Ballot Measure No. 1 by urging a "Yes" vote thereon.

Respectfully submitted,

Kenneth Kraemer, for the minority.

Approved October 1, 1963, by the Research Board for transmittal to the Board of Governors.

Received by the Board of Governors October 3, 1963 and ordered printed and submitted to the membership for discussion and action.